STATE OF NEW YORK

DIVISION OF TAX APPEALS

In the Matter of the Petition	:	
of	:	
LATZ LANDSCAPING, INC.	:	
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1993 through May 31, 1999.	:	DETERMINATION DTA NOS. 819252 AND 819253
In the Matter of the Petition	:	
of	:	
GLEN LATZ	:	
for Revision of a Determination or for Refund of Sales and Use Taxes under Articles 28 and 29 of the Tax Law for the Period June 1, 1998 through May 31, 1999.	:	

Petitioner Latz Landscaping, Inc., c/o Glen Latz, President, 65 Piermont Road, Tenafly, New Jersey 07670, filed a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1993 through May 31, 1999.

Petitioner Glen Latz, 65 Piermont Road, Tenafly, New Jersey 07670, file a petition for revision of a determination or for refund of sales and use taxes under Articles 28 and 29 of the Tax Law for the period June 1, 1998 through May 31, 1999.

A hearing was commenced before Brian L. Friedman, Administrative Law Judge, at the offices of the Division of Tax Appeals, 641 Lexington Avenue, New York, New York, on September 17, 2003 at 10:30 A.M. and was concluded at the same location on September 18,

2003 at 9:30 A.M., with all briefs to be submitted by August 13, 2004, which date began the six-month period for the issuance of this determination. Petitioners appeared by Kane Kessler, P.C. (Michael A. Zimmerman, Esq., of counsel). The Division of Taxation appeared by Christopher C. O'Brien, Esq. (James Della Porta, Esq., of counsel).

ISSUES

I. Whether the Division of Taxation properly determined additional sales and use taxes due from petitioners for the periods at issue.

II. Whether the Division of Taxation has sustained its burden of proof to show that the imposition of fraud penalty pursuant to Tax Law § 1145(a)(2) was proper.

FINDINGS OF FACT

In their brief filed on March 5, 2004, petitioners submitted 99 proposed findings of fact, each of which has been substantially incorporated into the following Findings of Fact except for:

a. Proposed findings of fact "3" through "6", "11", "13", "14", "33", "79" and "80" which are irrelevant to this proceeding and are, therefore, excluded; and

b. Proposed findings of fact "17", "18", "23", "24", "35", "36", "42", "48", "51", "56" through "59", "61", "65 " through "74 ", "76 ", "78 ", "81 " through "84 ", "86 " through "92 " , "94 ", "95 " and "97 " through "99 " which are rejected as not being supported by the record herein.

1. On June 7, 2001, the Division of Taxation ("Division") issued a Notice of Determination to Latz Landscaping, Inc. ("Latz") which assessed additional sales and use taxes in the amount of $167,240.90, plus penalties and interest, for a total amount due of $401,615.65 for the period June 1, 1993 through May 31 ,1999. Included in the penalties assessed was a $10,000.00 penalty pursuant to Tax Law § 1145(a)(3)(i) for failure to obtain a certificate of

authority under Tax Law § 1134 and penalty pursuant to Tax Law § 1145(a)(2) on the ground that the failure to pay or pay over the tax was due to fraud.

On June 29, 2001, the Division issued a Notice of Determination to Glen Latz, as an officer or responsible person of Latz, in the amount of $69,771.35, plus penalties and interest, for a total amount due of $146,125.42 for the period June 1, 1998 through May 31, 1999. The penalty for failure to obtain a certificate of authority and the fraud penalty assessed against Latz were also assessed against petitioner Glen Latz.

2. At the hearing held in this matter, the Division conceded that it had no evidence that Latz was in business prior to the year 1995. Accordingly, all tax and penalties assessed for the period June 1, 1993 through November 30, 1994 are hereby canceled.[1]

Also, at the hearing, petitioner Glen Latz conceded that, pursuant to Tax Law §§ 1131(1) and 1133(a), he was a person responsible for the collection of sales and use taxes on behalf of Latz and that he was personally responsible therefor.

3. Pursuant to a request by an auditor of the Division, Ujwal Durve, and his team leader, James Pendergast, John Barr, an investigator employed by the Division, drove to 11 Highview Avenue, Orangeburg, New York on September 14, 1999 in an attempt to ascertain whether Latz was conducting business from that address. On his way to the Highview Avenue address, the investigator passed the premises of Bell Atlantic at 616 Route 303, Blauvelt, New York when he noticed a truck in the driveway which bore the name Latz Landscaping. Mr. Barr observed grass clippings being removed and saw a lawnmower which had yet to be returned to the truck. Inside the premises of Bell Atlantic, the investigator was informed that Bell Atlantic contracted with

[1] The tax assessed for each of these six sales tax quarters was $.01 per quarter. However, total penalties assessed for such quarters totaled $5,872,71.

Colin Service Systems, Inc. ("Colin") for general maintenance. After speaking with other individuals, Mr. Barr was informed that Latz was one of Colin's subcontractors.

Mr. Barr then drove to the 11 Highview Avenue address where he observed a building "similar to a house" which seemed to be used for a business. He observed landscaping vehicles of various types and also saw a sign on the lawn which said "Latz". Inside, he spoke to Glen Latz.

The investigator spoke with representatives of Colin who furnished him with copies of checks issued to Latz during the year 1999. Mr. Barr was asked by the Division's auditors to issue subpoenas to various banks: Fleet Bank, Commerce Bank and PNC Bank.

4. This audit was apparently commenced as a result of an observation by two Division auditors (James Pendergast and Lou Finch) who were on business at Blue Hill Plaza in Pearl River, New York when they observed Latz trucks and crew performing work at that location. Mr. Pendergast telephoned his office and spoke with Ujwal Durve who checked on his computer and found that Latz was not registered as a vendor for purposes of New York State sales tax. In checking the Division's computer records, Mr. Durve also discovered that Latz had filed no New York State franchise tax reports for the years 1995 through 1999.

An initial appointment letter was sent by Auditor Durve to Latz at 60 Coopers Lane, Rivervale, New Jersey on August 13, 1999. The Coopers Lane address was obtained by Mr. Durve's supervisor, James Pendergast. The letter scheduled a field audit[2] for September 16, 1999 and requested that the following be produced for examination at the scheduled appointment:

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[2] The appointment letter indicated thereon that the audit period was June 1, 1993 through May 31, 1999.

> All books and records pertaining to your sales and use tax liability, for the period under audit, must be available on the appointment date. This includes financial statements, journals, ledgers, sales invoices, purchase invoices, cash register tapes, federal income tax returns, and exemption certificates.

On the same date, Mr. Durve telephoned the Orangeburg, New York address and was told to contact Latz's accountant, John Michaels which he did. When he received no response, Mr. Durve telephoned Latz on August 31, 1999 and left a message; on the same day, Mr. Durve received a call from a Mr. Latz who stated that he was "not the Latz that you're looking for." That person told Mr. Durve that Glen Latz's office was located at 11 Highview Avenue in Orangeburg, New York and also provided Mr. Durve with the telephone number. When the auditor placed the call, the telephone was answered "Latz Landscaping."

The auditor did receive a telephone call from Accountant Michaels who stated that Latz had no business in New York and that Latz's business address was 60 Coopers Lane in Rivervale, New Jersey. Mr. Michaels informed the auditor that the Orangeburg, New York address was for a different company (also owned by Glen Latz) known as Commercial Snow Services, Inc.

Auditor Durve was hired as a sales tax auditor by the Division in April 1999, approximately four months prior to the commencement of this audit. He has a masters degree in accounting from India but he did not study laws of the United States there. The audit at issue in this proceeding was the ninth or tenth audit which Mr. Durve was involved in.

5. On October 19, 1999, the auditor met with Mr. Michaels at his office in New Jersey. When he again stated to the auditor that Latz had no taxable sales in New York, he was informed of the observations of the Division's auditors. Mr. Michaels then told the auditor that Latz had only one job in New York and that the job was not subject to sales tax. He presented to the

auditor a contract between Latz and Mack-Cali Realty L.P., a managing agent for One and Two Blue Hill Plaza, Pearl River, New York, dated April 1, 1998, wherein Latz was to perform exterior landscaping services at Blue Hill Plaza for the period April through November 1998. The auditor's Tax Field Audit Record notes that on October 19, 1999, he asked Mr. Michaels for Latz's sales invoices for the audit period.

Latz's accountant informed the auditor that the receipts from all of Latz's sales are deposited into an account at the PNC Bank. The accountant agreed to provide the auditor with bank deposit records and New Jersey sales tax returns; he indicated that the returns were prepared from the bank deposits and after reviewing the deposit records and returns, the auditor concluded that they were in substantial agreement.

Again, in October 1999, the auditor made both an oral and a written request for the books and records of Latz to its accountant, John Michaels.

The auditor asked Mr. Michaels for a copy of the lease on the Orangeburg, New York premises, but it was never provided to him. He did receive a canceled check from Commercial Snow Services, Inc., signed by Glen Latz, for the sum of $1,750.00 payable to E.C.H. Holding for "yard rent." On the top of the check was handwritten "Latz 11 Highview." Mr. Michaels stated that the premises were rented by Commercial Snow Services, Inc. and not by Latz. Commercial Snow Services, Inc. is registered as a vendor for sales tax purposes with the State of New York and files New York State sales tax returns

6. During the course of the audit, Latz retained the services of an attorney, Robert Stern, of the firm of Deener, Feingold & Stern of Hackensack, New Jersey. A conference between the auditor and Mr. Stern was scheduled for March 21, 2001 and subsequently rescheduled for March 27, 2001. The auditor sent letters to Mr. Stern dated February 21, 2001 and March 12,

2001, respectively, to confirm these conferences and in the letters asked that a sales journal, purchase journal, purchase invoices for material used in New York jobs and sales invoices for Blue Hill Plaza and Clarins be provided.

Latz's representatives during the initial stages of the audit (Mr. Michaels and Mr. Stern) suggested to the auditor that the year 1998 be used as a test period. Mr. Stern indicated to the auditor that it would be impossible to provide all of the invoices for the entire audit period. The auditor then asked for all of the sales invoices, purchase invoices and sales and purchase journals for 1998, but he was informed by Mr. Stern that Latz does not maintain a sales or purchase journal and, therefore, that the auditor's request was unreasonable. The auditor utilized the information from 1998 because that was all that was provided to him.

Initially, invoices were requested and were provided for the months of October, November and December 1998 for both New York and New Jersey sales; subsequently, invoices for the balance of 1998 were furnished to the auditor. The auditor was also provided with PNC bank statements as well as New Jersey and Federal returns for 1996 and 1998. Despite the request by the auditor, the following records were not provided: New Jersey sales tax returns for the entire audit period; Federal returns for two of the years under audit; general ledger; sales journal; purchase journal; purchase invoices; bank deposit slips; canceled checks; all monthly bank statements; resale certificates; exemption certificates; and capital improvement certificates.

7. For the months of October through December 1998, pursuant to the invoices furnished to the auditors, Latz's gross sales were found to be $228,256.83; New York gross sales were computed to be $163,131.06, or 71.47% percent of total gross sales. Pursuant to the PNC Bank deposit records provided to the auditor, bank deposits for the period October through December 1998 totaled $63,282.17.

While the auditor asked to photocopy the invoices for the last quarter of 1998, Latz's accountant, John Michaels, denied permission since he indicated that his client had not granted him permission to do so.

8. Attorney Stern thereafter provided sales invoices for the balance of the 1998 year. The invoices were shown to the auditor and his supervisor at Mr. Stern's office on January 11, 2001. The invoices were shown to the auditors but when they asked to photocopy the invoices, Mr. Stern indicated that he did not have his client's permission to make copies thereof.

The total sales per the invoices provided to the auditors for 1998 were $329,371.70; New York sales upon which tax was supposed to have been charged were $115,696.38, or 35 % of the total sales. The total sales tax charged by Latz on these invoices was $8,388.45.

In his review of the invoices for 1998, the auditor determined that there were New York sales by Latz for which tax should have been but was not charged. The total of these sales was $138,305.00, or 41.9% of the total sales per invoices. The vast majority of the sales for which the auditor determined tax should have been but was not charged by Latz were to Lederle Lab.

9. When the auditor, Mr. Durve, was initially provided with invoices for the October through December 1998 period, he was shown an invoice to Palisade Center Mall on which sales tax was charged to that customer. Subsequently, when he was provided with invoices for the entire 1998 year, that invoice was not included.

10. Latz's accountant, Mr. Michaels, informed the auditor that the account at PNC Bank was the sole account maintained by Latz. Subsequently, Mr. Durve asked the Division's investigator, John Barr, to contact Latz's customers and obtain canceled checks in order to verify that Latz did, in fact, have just the one bank account at PNC Bank. From Latz's customer, Colin Services, Mr. Barr ascertained that Latz made deposits with Fleet Bank and Commerce Bank as

well. Bank records were subpoenaed from all three banks, but PNC Bank refused to comply with the subpoena.

For the year 1998, Latz's Fleet Bank deposits totaled $1,141,067.18. On its Federal income tax return for 1998, Latz reported gross sales of $154,880.00. The auditor advised Latz's attorney, Mr. Stern, of this large discrepancy.

11. To compute total additional tax due, the auditor made the assumption that deposits into any bank except PNC Bank were New York sales. This assumption was based upon the statement made by Latz's accountant that all New Jersey sales were deposited into the PNC Bank account and because the New Jersey sales tax returns were in substantial compliance with the PNC deposit records supplied by the accountant.

Since Latz charged sales tax on 35% of its sales per the invoices supplied and since 41.9% of the sales were disallowed as exempt sales (***see***, Finding of Fact "8"), the auditor applied these combined percentages to the total Fleet deposits for the period August 1995 through June 1999, the total of which was $2,999,682.37. The result of applying the total of the above percentages (76.9%) to the bank deposits resulted in taxable sales of $2,306,755.74 with additional tax due thereon, computed at the applicable tax rate of 7.25%, of $167,239.79.

After arriving at the additional tax due, the auditor gave both Mr. Michaels (Latz's accountant) and Mr. Stern (Latz's attorney) the opportunity to file sales tax returns and to pay the tax due. Neither did so. Mr. Stern indicated that he might be able to settle the matter but only if he received written confirmation from the auditors that they would not notify any other taxing authorities about the additional taxes due.

12. The auditor determined that the fraud penalty should be imposed. Among the reasons for his imposition of the fraud penalty were the following:

a. For some customers, Latz charged and collected sales tax, but did not remit the tax to the Division;

b. Latz's representatives made the following misleading statements to the auditor during the audit: (1) Latz had no business in New York; (2) Latz, while it had some business in New York, made no taxable sales in New York; and (3) Latz maintained only one bank account, i.e., the PNC Bank account;

c. No sales journals were maintained by Latz which could be matched to the other bank deposits;

d. Latz's Federal income tax return for 1998 reported sales of $154,880.00 while the bank deposits to the Fleet Bank account alone were $1,141,067.18 for that year;

e. Latz's representatives refused to allow the auditors to make copies of sales invoices during the audit;

f. The auditors were not provided with purchase invoices so that they could determine if sales tax had been paid on materials allegedly used in performing capital improvement jobs;

g. The auditor was unable to determine if all sales invoices for 1998 were supplied because he was not provided with any sales journal, bank deposit slips or bank statements to verify the accuracy of the sales invoices; and

h. On a number of occasions, the auditor observed Latz's trucks crossing the Tappan Zee Bridge into Westchester County which led him to believe that Latz was performing work in New York.

13. In May 2000, Latz's accountant furnished the auditor with a copy of a Direct Payment Permit in the name of American Cyanamid Co. of Philadelphia, Pennsylvania, the effective date

of which was August 1, 1965. Lederle Pharmaceuticals ("Lederle"), a customer of Latz, is a division of American Cyanamid Co. Lederle subsequently became known as "Wyeth" which was located in Pearl River, New York. At the time that the Direct Payment Permit was provided to the auditor, three invoices were attached to the permit. The auditor asked for a copy of the contract between Latz and Lederle (he indicated that most maintenance contracts have a clause which specifies who will pay the tax), but no contract was provided to him.

Prior to the hearing held in this matter, Attorney Michael A. Zimmerman, petitioners' representative at the hearing, furnished the auditor with a letter from Wyeth, addressed "To Whom It May Concern" which stated as follows:

> We certify that, unless we advise you to the contrary in writing, all billings for delivery to us at North Middletown Road, Pearl River, New York 10965 are made under the authority of a currently valid Direct Payment Permit No. DP-000341 for American Cyanamid Company.
>
> Accordingly, please do not bill New York State and Local Sales Tax on our purchases for delivery to the above address.
>
> Our New York State and Local Sales and Use Tax Registration Number is 13-04308890.

A similar letter from Lederle (from R.J. DePasquale, Manager, General Accounting) was sent, by fax, to another Division Investigator, Christine Sicina, on August 18, 2003 referencing the same instructions, Direct Payment Permit number and Sales and Use Tax Registration number.

Of the total disallowed nontaxable sales ($138,305.00) which made up the 41.9% used in the auditor's computation of additional tax due (***see***, Findings of Fact "8" and "11"), the sales to Lederle for the period were in the sum of $137,445.00.

At hearing, when asked by Mr. Zimmerman, why he chose not to exclude the sales to Lederle from disallowed nontaxable sales, the auditor, Mr. Durve, indicated that since he was not

provided with the Direct Payment Permit until 2000, he was instructed by his superivisor and his section head to disregard the permit and to deem taxable the sales to Lederle. The auditor, during cross examination by Mr. Zimmerman, was asked if he knew why his supervisor, Mr. Pendergast, told him not to consider the Direct Payment Permit, stated that "I don't question my supervisor." The auditor agreed that if the sales by Latz to Lederle had been allowed as nontaxable, then just approximately 35% of the New York sales for 1998 would have been taxable.

14. On February 4, 2003, the Division received from Latz a New York State Amnesty Application for the period December 1, 1993 through December 31, 1999 on which it was indicated that total tax due was in the amount of $23,456.00 for this period. Sales tax returns for most of the sales tax quarters covered by the application were filed with the application.

On July 18, 2003, the Division issued a Statement of Amnesty Account to Latz which indicated that tax amnesty had been granted for the period December 1, 1993 through November 30, 1995, December 1, 1998 through February 28, 1999 and December 1, 1999 through February 29, 2000. However, the Statement of Amnesty Account also indicated that balances were due, including interest for the period December 1, 1995 through November 30, 1998 and for the period September 1 through November 30, 1999 (the total due under amnesty was $6,441.66). The Division's statement also indicated that for the periods ended May 31, 1996, May 31, 1999 and August 31, 1999, the returns submitted had not completed processing through the Division's systems.

In furtherance of its amnesty application, petitioners submitted to the Division on February 9, 2004, a partial withdrawal of petition in order to qualify for amnesty. Pursuant to this partial withdrawal, petitioners conceded tax due in the amount of $23,456.00 for the period December

1, 1993 through December 31, 1999, but do not concede that any further sales tax is due for this period. The partial withdrawal further states that petitioners continue to contest sales tax due above the amount of tax on their amnesty application.

15. Petitioner Glen Latz indicated that out of approximately 400 to 500 customers of Latz, only 4 customers were located in New York State, to wit: Colin Service Systems, Blue Hill Plaza, Clarins and Lederle, each of which was a commercial account. Glen Latz also owns Commercial Snow Services, Inc., a commercial snow and deicing company that does business in New York and New Jersey. Commercial Snow Services, Inc. files its own returns and pays sales tax to both states.

16. According to Glen Latz, Latz does not maintain a sales journal (invoices are generated from a computer system) or a purchase journal (a computerized listing of suppliers, materials purchased and amounts paid is generated).

17. Latz did not charge or collect sales tax on services performed for Lederle as a result of the instructions on the purchase orders from Lederle which stated as follows: "NOTICE: Do not charge N.Y. State and Local Sales/Use Tax. We will pay to N.Y. State taxes due under our valid Direct Payment Permit - No. DP - 000341. (Reg. No. 13-0430890)."

18. Colin Services, a customer of Latz, is located in White Plains, New York. It maintains buildings for Bell Atlantic in Orange, Rockland, Putnam and Westchester counties (approximately 90 locations). While the Division's auditor did not impose tax on Latz for its services to Colin Services, it was the first company visited by Investigator Barr.[3] Glen Latz indicated that pursuant to Latz's contract with Colin Services, it was stated that no tax would be

[3] Petitioner Glen Latz asserts that the contract between Latz and Colin Services provided that no tax was to be charged by any subcontractor working under the Bell Atlantic Contract. While this contract is not part of the record herein, apparently this assertion was borne out by Investigator John Barr when he obtained copies of canceled checks from Colin Services (***see***, Finding of Fact "3").

paid to any subcontractor under the Bell Atlantic contract but that Colin Services would pay the tax directly to the Division.

19. Blue Hill Plaza, a customer of Latz, is a corporate park located in Pearl River, New York. Latz contracted to do both maintenance and capital improvement work at this site. Glen Latz admitted some of the services performed for Blue Hill Plaza were taxable sales; Latz collected the tax, but did not remit the tax to the State of New York until it made its application for amnesty in February 2003.

20. Clarins is a small manufacturing facility in Orangeburg, New York. It entered into a contract with Latz whereby Latz agreed to perform certain maintenance work and capital improvements on site. Glen Latz admitted that some of the services performed for Clarins were taxable. Latz collected the tax but did not remit it to the State of New York until it made its application for amnesty in February 2003.

21. When asked on direct examination by his representative, Attorney Michael Zimmerman, why there was a discrepancy between Latz's Federal income tax returns and the schedules prepared by Glen Latz purporting to show total sales, New York sales and taxable sales for the audit period (these schedules were not supplied to the auditor during the audit but were prepared and furnished to the auditor approximately one week prior to the hearing), Glen Latz indicated that the business grew at a rapid rate from 1996 to 1998, he signed returns prepared by his accountant without properly reviewing them and, while Latz is no longer in business, he was now attempting to come into compliance. Glen Latz also stated that while he was aware that certain services performed by Latz were subject to New York State and local sales tax, he was unaware that he was required to register as a vendor with the State. Glen Latz has no accounting background although his wife, who is a certified public accountant, assisted

him in preparing some of the schedules submitted to the auditor shortly before the hearing. Although sales tax was collected by Latz on some of its sales to New York customers, Glen Latz blamed his bookkeepers for failure to remit the tax. In some instances, he indicated that the bookkeepers erroneously remitted the tax to New Jersey.

SUMMARY OF THE PARTIES' POSITIONS

22. The position of petitioners may be summarized as follows:

a. In arriving at the tax liability of Latz in the amount of $167,240.90, plus penalties and interest, the auditor applied a percentage of 76.9% of total sales in 1998 of $1,141,067.18. This percentage ignored a direct payment permit which applied to Latz's sales to Lederle which, if properly considered by the auditor, would result in a substantial reduction in additional tax due for the audit period;

b. Fraud penalty should not be imposed based upon the failure of Glen Latz to cooperate with the auditors during the audit since all transactions were done through petitioners' representatives, Accountant Michaels and Attorney Stern. Latz's failure to register with the State of New York as a sales tax vendor is not an indication of fraud. Glen Latz contends that he provided his attorney with three boxes of some 4,000 invoices which he assumed would be provided to the auditors upon audit. Glen Latz alleges that he paid Attorney Stern approximately $55,000.00 for his representation, but that he was not satisfied with the attorney's handling of the case and subsequently discharged him as counsel. Moreover, petitioners contend that rather than examine, in detail, all of the invoices provided by Glen Latz, the auditors chose a three-month test period consisting of the period October 1 through December 31, 1998 and that petitioners should not be penalized for the auditors' failure to perform a detailed audit

c. Petitioners submitted to Auditor Durve, a short time before the hearing, a series of documents purporting to set forth total receipts for 1998 and details pertaining to the total receipts including those receipts which were New York receipts and, of New York receipts, those which were subject to sales tax. Along with these documents, petitioner provided a schedule pertaining to New York receipts for 1998 which indicated that total New York receipts for 1998 were $530,775.93, with exempt sales in the amount of $437,370.08 consisting of capital improvement sales of $232,118.33 and sales for which the customer paid the tax directly to the State (Colin and Lederle) of $205,251.75. Accordingly, taxable sales per petitioners' documents totaled $93,405.85 or 17.6% ($93,405.85 ÷ $530,775.93) instead of 35% as computed by the auditor;

d. Petitioners also introduced an exhibit, from petitioners' computer system, allegedly setting forth total receipts for the years 1993 through 1998 with names of customers, check numbers, check amounts and dates received. This exhibit states that Latz had no New York sales for the years 1993 through 1995, but, using a formula utilized by the auditor (that 28.8 % of the Fleet Bank deposits represented New York sales), resulted in New York sales of $97,204.04 for 1996, $184,334.36 for 1997 and $361,253.89 for 1998. Then, again using a formula employed by the auditor of 37% of New York sales being taxable, this exhibit stated that Latz had taxable sales of $35,965.49 for 1996, $68,203.71 for 1997 and $133,663.93 for 1998, or total taxable sales for the three-year period of $237,833.13, with tax due thereon, at 7.25%, of $17,242.90. Accordingly, petitioners maintain that the returns filed with the amnesty application and the tax paid therewith ($23,456.00) properly reflects the sales tax due to New York State.

23. In response, the Division contends as follows:

a. Because incomplete and inadequate books and records were provided by petitioners on audit, the Division had the right to estimate tax due. No sales records were provided for periods prior to 1998, and the auditors could not verify that all invoices were provided for 1998 (the invoices provided by Attorney Stern for 1998 did not include some of the invoices for the period October 1 through December 31, 1998 which had been provided by Accountant Michaels and the bank deposits into the Fleet Bank account did not reconcile with amounts reported on Latz's Federal income tax returns);

b. Even if petitioners are able to meet their burden of proving that sales for 1998 were less than were determined by the auditors, no adjustment is warranted for periods outside 1998, i.e., petitioners should not be rewarded for failing to produce any sales records for periods prior to 1998;

c. An exemption certificate received by a vendor more than 90 days after the sale does not satisfy the vendor's burden of proof concerning the taxability of the transaction (Tax Law § 1132 [c]; 20 NYCRR 532.4). Petitioners failed to produce a direct payment certificate within 90 days after receiving a letter from the Division setting forth the books and records required for audit;

d. Since the schedules for 1998 were presented to the auditor just six days prior to the hearing, thereby preventing the auditor from checking into their accuracy, an inference must be drawn that such documents were not credible. No source documents were attached to the schedules submitted and the schedules should, therefore, be deemed unreliable;

e. Petitioners must properly be held liable for the fraud penalty imposed by the Division for the following reasons: (1) petitioners collected but did not remit sales tax to

the Division; (2) Latz failed to register as a vendor for sales tax purposes with New York State; (3) Latz failed to file corporation tax reports and withholding tax returns with the State for the periods at issue; (4) Latz grossly underreported its gross sales on its Federal income tax returns for the periods at issue; (5) petitioners (and their representatives) were uncooperative and made numerous misrepresentations to the auditors during the audit; and

f. If fraud penalty is determined to have not been properly imposed, negligence penalty should, in the alternative, be imposed upon petitioners.[4]

CONCLUSIONS OF LAW

A. Where a taxpayer's records are insufficient, unreliable and inadequate to verify, upon audit, the amount of sales and use taxes due for the period under examination, the Division is authorized to estimate such tax liability on the basis of external indices (Tax Law § 1138[a][1]; ***see***, ***Matter of Ristorante Puglia, Ltd. v. Chu***, 102 AD2d 348, 478 NYS2d 91, 193; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, 85 AD2d 858, 446 NYS2d 451, 452). In the present matter, despite numerous requests by the Division's auditors for production of books and records for the audit period, petitioners' representatives produced some sales invoices for the year 1998 only, and the auditors were not permitted to make copies of the invoices or to remove them from petitioners' representatives' offices. The auditors were initially informed that Latz maintained just one bank account and that all of its receipts were deposited into that account; subsequently, it was discovered that Latz had additional bank accounts. No sales journals were provided to the auditors from which the sales invoices or bank deposits could be reconciled. New Jersey sales tax returns, Federal returns for two of the years under audit and numerous other records sought (***see***, Finding of Fact "6") were not made available for examination by the

[4] In its answer, the Division asserted negligence penalty in the alternative to the fraud penalty.

Division's auditors. The bank deposit records from just one of Latz's accounts (Fleet Bank) for 1998 showed deposits which greatly exceeded the sales reported on its Federal income tax return for the year. No purchase invoices were provided to enable the auditors to ascertain if sales tax had been paid on materials allegedly used in performing nontaxable capital improvement jobs by Latz. Clearly, therefore, the books and records made available to the auditors were insufficient, unreliable and inadequate to verify gross and taxable sales for the audit period and the Division was justified in resorting to an indirect audit method to estimate Latz's sales tax liability.

Where, as here, the Division seeks to determine a taxpayer's sales tax liability on the basis of an indirect audit method, the methodology selected must be reasonably calculated to reflect the taxes due (***Matter of Ristorante Puglia, Ltd. v. Chu***, ***supra***; ***Matter of W.T. Grant Co. v. Joseph***, 2 Ny2d 196, 159 NYS2d 150, 157, ***cert denied*** 355 US 869). However, exactness in the outcome of the audit method is not required (***Matter of Markowitz v. State Tax Commn.***, 54 AD2d 1023. 388 NYS2d 176, 177, ***affd*** 44 NY2d 684, 405 NYS2d 454; ***Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990). The burden rests with the taxpayer to show by clear and convincing evidence that the methodology was unreasonable or that the amount assessed was erroneous (***Matter of Meskouris Bros. v. Chu***, 139 AD2d 813, 526 NYS2d 679; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, ***supra***).

B. As previously noted, the only invoices presented and the only records made available for audit were records for the year 1998. Total sales per the invoices provided to the auditor for 1998 were $329,371.70. New York sales upon which tax was supposed to have been charged were determined to be $115,696.38, or 35% of total sales. Additionally, the auditor determined that there were other New York sales by Latz for which tax should have been but was not charged. These sales totaled $138,305.00, or 41.9% of the total sales per the invoices.

Combining these two percentages (35% + 41.9% = 76.9%), the auditor applied the 76.9% to Latz's Fleet Bank deposits for the period August 1995 through June 1999 which totaled $2,999,682.37. The rationale for this audit method was that Auditor Durve was informed by Latz's accountant that all sales receipts were deposited into the PNC Bank account, and since the New Jersey sales tax returns were in substantial compliance with the PNC deposit records, it was assumed by the auditor that any funds deposited into Fleet Bank or any bank other than PNC Bank must be New York sales.

C. While the audit method must be found to be reasonable under the circumstances herein, the audit results require some adjustments.

20 NYCRR 532.5 provides, in pertinent part, as follows:

> (a) *General*. A direct payment permit is a notice to a vendor that the holder thereof is authorized to pay directly to the Department of Taxation and Finance any tax due on purchases made. The vendor's responsibility for the collection of tax from the permit holder is waived upon receipt of such permit.
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> * * *
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> (e)(3) Direct payment permit holders are required to notify vendors, from whom they make purchases, of their status by submitting a copy of the direct payment permit with the first purchase order. Each vendor accepting a direct payment permit must, for verification purposes, maintain a method of associating a sale for which the permit was used, with the permit on file.

In the present matter, Latz has produced a Direct Payment Permit for its customer, Lederle, a division of American Cyanamid Co. and a letter from Wyeth (Lederle subsequently became known as Wyeth) directing its vendors not to bill State and local sales tax on purchases made by Wyeth. In the letter, reference was made to the aforementioned Direct Payment Permit possessed by American Cyanamid. Accordingly, Latz was not required to collect and remit sales tax on its sales to Lederle.

Citing ***Matter of Gartner Group, Inc***. (Tax Appeals Tribunal, December 8, 1994), the Division contends that the 90-day rule set forth in Tax Law § 1132(c)(1) and 20 NYCRR 532.4(b)(4)(iii) are applicable to direct pay permits. This rule states that a vendor who in good faith accepts from a purchaser a properly completed *exemption* certificate or other documentation evidencing *exemption* from tax not later than 90 days after delivery of the property or rendition of the service is relieved of liability for failure to collect the tax with respect to that transaction. A careful reading of ***Matter of Gartner Group, Inc.*** (***supra***) does not lead me to conclude that the Division is correct in its contention. First, that Tribunal decision and the Administrative Law Judge determination which was affirmed thereby make no mention of 20 NYCRR 532.4, a section of the regulations which pertains to exemption documents. It is 20 NYCRR 532.5 which relates to direct payment permits which is referenced by ***Gartner.*** While the Division is correct in its assertion that Tax Law § 1132(c) is, in fact, specifically cited in ***Gartner***, it must be noted that subdivision (1) of that section, like 20 NYCRR 532.4, pertains to exemption documents while subdivision (2), like 20 NYCRR 532.5, deals specifically with direct pay permits. Direct pay permits are not exemption documents similar to resale certificates, certificates of capital improvement or exempt use certificates because unlike these exemption documents, a direct pay permit does not exempt the transaction from tax but, instead, is a notification to a vendor that the holder of such permit is authorized to pay any tax due on its purchases directly to the Division. The transaction is not exempt from tax, and statutes and regulations pertaining to exemption documents are, therefore, not applicable.

The applicable regulation, 20 NYCRR 532.5(e)(3) requires a direct payment permit holder to notify its vendors of such status by submitting a copy of the direct pay permit with the first purchase order. In the matter at issue herein, there is no evidence that Lederle failed to comply

inasmuch as petitioners have produced both the direct pay permit and a letter from the vendor referencing the same.

In his computations, Auditor Durve, apparently under instructions from his supervisor, erroneously disregarded this Direct Payment Permit and included in his computation of the percentage of nontaxable sales. For the year 1998, the period used by the auditor in making his calculation, Latz made sales to Lederle, exclusive of capital improvement work, which totaled $137,445.00. This amount must be deducted from the total of disallowed nontaxable sales for the period which the auditor determined to be $138,305.00, thereby leaving a balance of $860.00. The percentage of disallowed sales must, therefore, be adjusted from 41.9% (***see***, Finding of Fact "8") to .26%.

As a result of this adjustment, it is hereby determined that, utilizing the audit method employed by the auditor, i.e., taking the bank deposits of Latz and applying the combined percentages of disallowed nontaxable sales (.26%) and New York sales upon which tax should have been charged by Latz (35%) results in taxable sales in the amount of $1,057,687.90 (35.26% of $2,999,682.37), with tax due thereon, computed at the applicable rate of 7.25%, in the amount of $76,682.37.

D. Based upon the facts that supporting documentation was not provided to substantiate the schedules produced for the hearing by petitioners and, in addition, that despite numerous requests therefor, sales and purchase invoices and other pertinent records were not provided by petitioners for periods other than the year 1998, it is hereby determined that such schedules submitted by petitioners are not credible and shall not be considered for purposes of any additional adjustments to the assessments herein.

Inasmuch as petitioner Glen Latz was assessed, as an officer or responsible person of Latz only for the period June 1, 1998 through May 31, 1999 and such personal responsibility has heretofore been acknowledged by this petitioner (***see***, Finding of Fact "2"), the assessment against Glen Latz must also be adjusted in accordance with the recalculations made in Conclusion of Law "C". By virtue of the aforesaid recalculations, tax due from Latz was reduced by 45.85% ($76,682.37 ÷ $167,239.83). Accordingly, the tax due from petitioner Glen Latz is reduced as follows: for the sales tax quarter ended August 31, 1998 from $13,705.83 to $6,284.12; for the quarter ended November 30, 1998 from $21,518.447 to $9,866.22; for the quarter ended February 28, 1999 from $12,974.62 to $5,948.86; and for the quarter ended May 31, 1999 from $21,572.43 to $9,890.96. The total tax due from petitioner Glen Latz is, therefore, $31,990.16.

E. Citing ***Matter of Albanese Ready Mix, Inc.*** (Tax Appeals Tribunal, June 15, 1989), the Division contends that even if petitioners establish entitlement to tax adjustments for 1998 based on the submission of exemption documents, no adjustment is warranted for periods outside the 1998 test period. This argument is without merit.

In ***Albanese***, that petitioner attempted to reduce its tax liability by utilizing an estimate of such liability. That is not the case in the present matter. The auditor, under the circumstances herein, properly estimated petitioners' tax liability using an indirect audit method. Petitioners, while failing to show that this method was unreasonable and was not reasonably calculated to reflect tax due did, however, sustain their burden of proving that the amount of tax assessed was erroneous (***see, Matter of Meskouris Bros. v. Chu***,***supra***; ***Matter of Surface Line Operators Fraternal Org. v. Tully***, ***supra***) and that, accordingly, adjustments were warranted.

This is the audit method which the Division chose to employ. A taxable percentage computed by using one year of sales was applied to Latz's bank deposits made for nearly all of the audit period. While it could be (and was) argued that to allow petitioners an adjustment to this taxable percentage might reward them for failing to produce sales records for periods prior to 1998, it would clearly be unjust not to allow such adjustment. The alternative to allowing such adjustment would be to invalidate the audit method entirely as being not reasonably calculated to reflect tax due, an alternative which the Division neither seeks nor likely would support.

F. Tax Law § 1145(a)(2) provides, in pertinent part, as follows:

> If the failure to pay or pay over any tax to the commissioner of taxation and finance within the time required by this article is due to fraud, in lieu of the penalties and interest provided for in subparagraphs (i) and (ii) of paragraph one of this subdivision, there shall be added to the tax (i) a penalty of fifty percent of the amount of the tax due, plus (ii) interest on such unpaid tax . . . .

G. In ***Matter of Cinelli*** (Tax Appeals Tribunal, September 14, 1989), the Tribunal provided the following guidance in determining whether a taxpayer may be subject to a civil fraud penalty:

> The burden of showing fraud under § 1145(a)(2) has consistently been interpreted to reside with the Division (***Matter of Ilter Sener d/b/a Jimmy's Gas Station***, Tax Appeals Tribunal, May 5, 1988; ***Matter of Nicholas Kucherov d/b/a Nick's Marine***, State Tax Commn., April 15, 1987, ***affd Kucherov v. Chu*** [147 AD2d 877, 538 NYS2d 339]). The standard of proof necessary to support a finding of fraud requires "clear, definite and unmistakable evidence of every element of fraud, including willful, knowledgeable and intentional wrongful acts or omissions constituting false representations, resulting in deliberate nonpayment or underpayment of taxes due and owing." (***Matter of Ilter Sener***, ***supra***, citing, ***Matter of Walter and Gertrude Shutt***, State Tax Commn., July 13, 1982).
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> For a taxpayer to be subject to a civil fraud penalty, willful intent is a critical element; the individual or the corporation, acting through its officers, must have acted deliberately, knowingly, and with the specific intent to violate the Tax Law (***Matter of Cousins Service Station, Inc.***, Tax Appeals Tribunal, August 11, 1988). Fraud need not be established by direct evidence, but can be shown by surveying the taxpayer's entire course of business and

drawing reasonable inferences therefrom (***see***, ***Korecky v. Commr.***, 781 F2d 1566 [11th Cir 1986]; ***Briggs v. Commr.***, 440 F2d 5 [6th Cir 1962]).

In ***Matter of Waples*** (Tax Appeals Tribunal, January 11, 1990), the Tribunal summarized some of the relevant considerations as follows:

> Because the sales tax penalty provisions are modeled after Federal penalty provisions, Federal statutes and case law are properly used for guidance in ascertaining whether the requisite intent for fraud has been established (***Matter of Uncle Jim's Donut and Dairy Store, Inc.***, Tax Appeals Tribunal, October 5, 1989; ***Matter of Ilter Sener***, ***supra***). Factors found to be significant include consistent and substantial understatement of tax, the amount of the deficiency itself, a pattern of repeated deficiencies, the taxpayer's entire course of conduct and the taxpayer's failure to maintain bank accounts or adequate records (***see***, ***Merritt v. Commr.***, 301 F2d 484; ***Bradbury v. Commr.***, T.C. Memo 1971-63; ***Webb v. Commr***., 394 F2d 366; ***see also***, ***Matter of AAA Sign Co.***, Tax Appeals Tribunal, June 22, 1989). Because direct proof of the taxpayer's intent is rarely available, fraud may be proved by circumstantial evidence, including the taxpayer's entire course of conduct (***Intersimone v. Commr.***, T.C. Memo 1987-290; ***Stone v. Commr.***, 56 T.C. 213, 223-224; ***Korecky v. Commr***., 781 F2d 1566). Fraud may not be presumed or imputed, but rather must be established by affirmative evidence (***Intersimone v. Commr.***, ***supra***). Hence, a finding of fraud should not be sustained where the attendant circumstances create at most only a suspicion of fraud (***Goldberg v. Commr.***, 239 F2d 316). The issue of whether fraud with the intent to evade payment of tax has been established presents a question of fact to be determined upon consideration of the entire record (***Jordan v. Commr.*** T.C. Memo 1986-389; ***see***, ***Matter of AAA Sign Co.***, ***supra***).

H. For the following reasons, it is hereby determined that the fraud penalty was properly imposed by the Division:

(1) Latz failed to register as a vendor with the State of New York as required by Tax Law § 1134. Petitioner Glen Latz also owned another company, Commercial Snow Services, Inc., which was registered in New York and which filed sales tax returns and paid over taxes to New York. Accordingly, despite his assertions to the contrary, it cannot be concluded that Glen Latz was unaware of the requirements to register with the State;

(2) Petitioners did collect tax from some of its customers (Blue Hill Plaza and Clarins) during the audit period, but failed to remit the tax until February 2003 when an amnesty application was made;

(3) During the course of the audit, petitioners' representatives made a number of false and misleading statements to the auditors, including: that Latz had no business in New York; that after learning that the auditors were aware of Latz's New York customers, that Latz made no taxable sales in New York; and that Latz maintained just one bank account, to wit, the PNC Bank account. In addition, the representatives refused to allow the auditors to make copies of the sales invoices which they presented during the audit;

(4) Latz maintained no sales or purchase journals from which it could be determined whether all sales were deposited into bank accounts as alleged by petitioners. No purchase invoices were made available from which the auditors could determine if sales tax had been paid on materials allegedly by Latz in performing nontaxable capital improvement jobs. The failure of a taxpayer to maintain a complete and accurate set of records is evidence of fraud (***Matter of Lefkowitz***, Tax Appeals Tribunal, May 3, 1990) ;

(5) Latz's Federal income tax return for 1998 reported sales of $154,880.00 while its deposits into the Fleet Bank account alone (and there were found to be two other banks at which accounts were maintained by Latz) totaled $1,141,067.18 for that year. While substantial underreporting alone is not enough to establish fraud, it is strong evidence of fraud (***Matter of Cousins Service Station, Inc***., ***supra***; ***Merritt v. Commr.***, ***supra***);

(6) The sales invoices purporting to represent all of Latz's sales for 1998 which were shown to the auditors by Attorney Stern did not include all of the invoices previously provided by Accountant Michael;

(7) At the time of the commencement of the audit in August 1999, Latz had failed to register as a vendor and had filed no New York State sales and use tax returns and no New York State corporation franchise tax reports which is evidence, as the Division correctly maintains, that it was attempting to conceal its presence in the State.

For the aforesaid reasons, it is hereby found that based upon petitioners' entire course of conduct, most notably their failure to remit sales tax collected from Latz's customers, to register or file any sales tax returns or to cooperate with the auditors during the audit, Latz and Glen Latz acted in a deliberate and knowing manner with the specific intent to evade and violate the Tax Law. Accordingly, the imposition of the fraud penalty pursuant to Tax Law § 1145(a)(2) is hereby sustained.

I. While petitioners did file an amnesty application (***see***, Finding of Fact "14"), it is unclear from the record whether they have qualified for amnesty or whether they have complied with the requirements therefor. This is true because their partial withdrawal, executed approximately one year after the filing of the amnesty application, is not a withdrawal at all since it does not withdraw the petition for any stated periods at issue and it states that petitioners continue to contest the amounts of tax due above the amount of their amnesty application. Moreover, since the Division, on its Statement of Amnesty Account, notified petitioners of outstanding balances for various periods for which amnesty was sought, it is unknown whether these balances were paid. Accordingly, the issue of amnesty shall not be considered in this proceeding.

J. The petitions of Latz Landscaping, Inc. and Glen Latz are granted to the extent indicated in Finding of Fact "2" and in Conclusions of Law "C" and "D"; the Division of Taxation is hereby directed to modify the Notice of Determination issued to Latz Landscaping,

Inc. on June 7, 2001 and the Notice of Determination issued to Glen Latz on June 29, 2001 accordingly; and, except as so granted, the petitions are in all other respects denied.

DATED: Troy, New York
February 3, 2005

/s/ Brian L. Friedman
ADMINISTRATIVE LAW JUDGE